



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date:	02/21/14	Bill No:	Assembly Bill 2681
Tax Program:	Sales and Use	Author:	Dababneh
Sponsor:	BOE	Code Sections:	RTC 6007 & 6009.2
Related Bill:		Effective Date:	Upon enactment

BILL SUMMARY

This bill specifies that any sale, storage, or use of counterfeit goods in this state constitutes a “retail sale” or “sale at retail,” under specified conditions.

ANALYSIS

CURRENT LAW

Counterfeiting. California law¹ makes it a crime, punishable by fines and imprisonment, for any person to willfully manufacture, intentionally sell, or knowingly possess for sale any counterfeit of a mark registered with the Secretary of State or the Principal Register of the United States Patent and Trademark Office.

Federal law² also makes it a crime, punishable by fines and imprisonment, for any person to willfully infringe a copyright, or to intentionally:

- Traffic in goods or services and knowingly use a counterfeit mark on or in connection with such goods or services,
- Traffic in labels, patches, stickers, wrappers, badges, emblems, medallions, charms, boxes, containers, cans, cases, hangtags, documentation, or packaging of any type or nature, knowing that a counterfeit mark has been applied thereto, the use of which is likely to cause confusion, to cause mistake, or to deceive,
- Traffic in goods or services knowing that such good or service is a counterfeit military good or service the use, malfunction, or failure of which is likely to cause serious bodily injury or death, the disclosure of classified information, impairment of combat operations, or other significant harm to a combat operation, a member of the Armed Forces, or to national security, or
- Traffic in a counterfeit drug.³

Federal law defines “counterfeit mark” to mean a spurious mark, the use of which is likely to cause confusion, to cause mistake, or to deceive. Among other things, a “counterfeit mark” also includes a spurious mark that is

- Used in connection with trafficking in any goods, services, labels, patches, stickers, wrappers, badges, emblems, medallions, charms, boxes, containers, cans, cases, hangtags, documentation, or packaging of any type or nature;

¹ Penal Code Section 350.

² Title 17 of the United States Code, Section 501 et seq., Title 18 of the United States Code, Section 2320.

³ Title 18 of the United States Code, Section 2320.

- Identical with, or substantially indistinguishable from, a mark registered on the principal register in the United States Patent and Trademark Office (USPTO) and in use, whether or not the defendant knew such mark was so registered; and
- Applied to or used in connection with the goods or services for which the mark is registered with the USPTO, or is applied to or consists of a label, patch, sticker, wrapper, badge, emblem, medallion, charm, box, container, can, case, hangtag, documentation, or packaging of any type or nature that is designed, marketed, or otherwise intended to be used on or in connection with the goods or services for which the mark is registered in the USPTO.

Sales and Use Tax Law. California law⁴ imposes the sales tax on the “retail sale” or “sale at retail” (hereinafter referred to as “retail sale”) of tangible personal property in this state. California law also imposes the use tax⁵ on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The sales or use tax is computed on the retailer’s gross receipts or the sales price, respectively, unless the law provides a specific exemption or exclusion.

The law⁶ defines a “retail sale” as a sale for any purpose other than resale in the regular course of business. With respect to illegal sales of goods in California, the law imposes a sales or use tax on the retail sales and purchases of those goods in the same manner as legitimate sales.

Under existing law, tangible personal property sold to persons who resell the property prior to any use of that property is not subject to sales or use tax. For example, sales or use tax does not apply to a toy manufacturer’s sale of toys to a wholesaler who resells the toys before making a taxable use of the toys.

In addition, tax does not apply to tangible personal property sold to persons who purchase the property to incorporate into a manufactured item to be sold.⁷ For example, tax does not apply to a supplier’s sale of fabric, plastic, and buttons to a doll manufacturer who incorporates these items into the manufactured doll to be resold. Also, tax does not apply to tangible personal property sold to retailers or other sellers who resell the property before they make a taxable use of the property. For example, tax does not apply when a toy manufacturer sells its finished products (toys) to a retail toy store for subsequent resale. Tax applies, however, when the retail toy store sells the toy to the consumer. The law regards that sale as a “retail sale.” The retailer is liable for the tax on the gross receipts or sales price of the toy sold to the consumer.

PROPOSED LAW

This bill revises the definition of “retail sale,” “sale at retail,” “use,” and “storage,” to include any sale or purchase in this state of tangible personal property by a “convicted seller” or a “convicted purchaser” with a counterfeit mark on, or in connection with, that sale, regardless of whether these sales are for resale in the regular course of business, subject to the following conditions:

- A notice of determination for any unreported tax on these sales or purchases to a convicted seller or convicted purchaser must be mailed within one year from the last day of the month following the conviction date.

⁴ Revenue and Taxation Code (RTC) 6007 of the Sales and Use Tax Law.

⁵ RTC 6201, et seq. of the Sales and Use Tax Law.

⁶ RTC Section 6007 of the Sales and Use Tax Law.

⁷ BOE Regulation 1525(b).

- Any fine imposed or restitution awarded under specified state and federal criminal provisions must be satisfied prior to the collection of tax from convicted sellers or convicted purchasers
- The unfair trade practice provisions⁸ in law do not apply to any person other than a convicted seller once the state imposes tax under the proposed law.

The bill defines “convicted seller,” “convicted purchaser,” and “counterfeit mark.”

As a tax levy, the bill becomes operative immediately upon enactment.

COMMENTS

1. **Sponsor and purpose.** The BOE voted unanimously to sponsor this bill and believes that California should impose a sales or use tax on *all* California sales and purchases of counterfeit goods when either the seller or purchaser is convicted of specified related crimes. Counterfeit good sales unfairly compete with the original brand, tarnish the reputation of the original brand, and cause a revenue loss. Moreover some counterfeit products potentially cause sickness or injury, such as counterfeit drugs or auto parts.

The Members of the BOE note that the bill allows the agency to impose tax on the source of the counterfeit products in California, whether it’s at the manufacturing, wholesale, or distributor level. The additional tax serves to minimize profits, and helps prevent the illegal products from entering the retail stream.

2. **What these new definitions accomplish.** If enacted, when a counterfeit goods seller or purchaser is convicted under state or federal law, the sales or use tax will apply to *any* sale and purchase of these items in this state, regardless of whether that sale is by the manufacturer, wholesaler, distributor, or retailer. With respect to these illegal sales, the proposed law does not allow for untaxed sales for resale under any circumstances. Also, the proposed law does not allow manufacturers, wholesalers, distributors, or retailers to claim a credit for the tax paid on their purchases of these illegal products or illegal components of the products.
3. **Offenders should not be rewarded with a tax exclusion.** The removal of the sale for resale exclusion is appropriate, considering these sales are illegal and can do significant harm to the public. It also enhances deterrence of this criminal activity.

COST ESTIMATE

The BOE’s administrative costs are absorbable.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The U.S. Customs and Border Protection Service (CBP) publishes seizure statistics annually.⁹ CBP reports numbers of seizures and their domestic value. Domestic value is the cost of the merchandise when it was last purchased. The statistics are comprehensive, and include all types of commodities seized. Most of the commodities

⁸ Chapter 5 (commencing with Section 17200) of Part 2 of Division 7 of, and Article 1(commencing with Section 17500) of Chapter 1 of Part 3 of Division 7 of, the Business and Professions Code, and Title 1.5 (commencing with Section 1750) of Part 4 of Division 3 of the Civil Code.

⁹ *Intellectual Property Rights: Fiscal Year 2012 Seizure Statistics*, U.S. Customs and Border Protection Office of International Trade.

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seized are those typically purchased by household consumers, such as electronics, shoes, pharmaceutical goods, CDs, clothes, and perfume. The statistics report seizures from all “shipping environments,” including cargo, express delivery, mail, and all other methods.

The CBP reports data for domestic value of seizures for federal fiscal years 2002 through 2012. No obvious trend is apparent in the data over the past ten years. Domestic seizure values have ranged from a low of \$93 million in 2005 to a high of \$273 million in 2008. In 2012, the latest fiscal year reported, seizures were \$146 million. For purposes of revenue estimation, we calculated a five-year average value of seizures of \$213 million.

State data are not broken out in the CBP report. Since most seized goods are ultimately purchased by consumers, we believe it is reasonable to assume that California seizures of counterfeit goods are reasonably represented by the state's 12% share of U.S. population, or \$25.5 million of total seizures.

REVENUE SUMMARY

Based on the CBP data discussed above, and assuming California's share of U.S. population, we estimate sales and use tax revenues to increase by about \$2.1 million per year on \$25.5 million in total seizures. Revenue estimate details are as follows:

Revenue Source	Rates	Dollars
State General Fund	3.94%	1,005,000
State Education Protection	0.25%	64,000
Fiscal Recovery Fund	0.25%	64,000
Local Revenue Fund	0.50%	128,000
Public Safety Fund	0.50%	128,000
Local Revenue Fund 2011	1.06%	270,000
Bradley Burns (Local Tax)	1.00%	255,000
Special District Tax	0.92%	235,000
Total State and Local Revenue	8.42%	\$2,149,000*

*Persons from whom this property is seized may face significant fines and imprisonment. Accordingly, total tax collections are likely to be considerably less.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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